

Ethics Standards for CalPERS External Managers : Best Practices *

- 1) Implement policy and procedures that insure fair and equitable allocation of investment opportunity among clients (ideally in auditable form).
- 2) Implement policy and procedures that insure fair and equitable allocation of pending transactions among clients (should be in auditable form).
- 3) Comprehensive disclosure on execution costs including comparisons with industry standards.
- 4) Comprehensive disclosure on soft dollar use if any.
- 5) Implement policies to promote an alignment of interests of investment professionals with clients including
 - a) compensation structures sensitive to investment performance measured over appropriate time frames
 - b) policies that promote investment in the firm's services by its professional staff
 - c) policies that limit other investments by its professional staff so as to avoid distraction
 - d) policies that strictly prohibit employee transactions from conflicting with client interests
- 6) Disclose compensation policies that require the investment or deferral of current income into the firm's products. In the absence of these policies, disclosure of the amount of top management and key product individual's net worth currently invested in the firm's products. If the firm cannot demonstrate that the firm's principles have a material portion of each year's current income or of net worth invested (among the firm's top 5 management as well as the key investment professionals on the subject product), then the firm needs to demonstrate policies that will achieve one or the other and a time frame for doing so.
- 7) Designate an individual in the legal or compliance department as the chief conflicts officer whose mission is to delineate all potential conflicts of interest that must be managed and to devise and implement procedures to insure that they are managed properly (reports to chief legal officer and to the committees outlined in point 8 below). This does not require a separate position.
- 8) Construct management structures to promote an environment of "compliance" and a culture of integrity from the top.
 - a) Form an ethics committee consisting of the firm's senior management whose charter is to craft the firm's code of ethics and review all violations by staff members
 - b) Form a compliance committee consisting of the firm's senior management and chaired by the firm's chief legal officer (CLO), whose charter includes responsibility for the scope and strength of the firm's compliance controls and periodic review of audit findings.
 - c) Compliance unit should report to the CLO.
- 9) Establish an independent ombudsmen (or facility) to make it possible for staff to "safely" report on problems or compliance issues to the compliance committee and to the firm's audit committee (if there is one).
- 10) Conduct a biannual review of compliance as to scope and adequacy of surveillance systems by a third party expert.
- 11) Ensure that the Chief Legal Officer and the internal audit function report independently to the Board.
- 12) Create an organization chart that delineates all reporting relationships and establishes clear lines of authority and responsibility

* Footnote: CalPERS may modify certain practices which very small firms deem to be cost prohibitive. Managers should make such appeals specific and directly to staff with an alternative plan of action suggested.